Ontario Energy
OEB
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'énergie
de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273

Ontario

BY E-MAIL

November 24, 2017

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Walli:

RE: OEB STAFF SUBMISSION
MOTIONS FILED BY HYDRO ONE INC. AND ORILLIA POWER DISTRIBUTION CORPORATION
EB-2017-0320

In accordance with the OEB's directions, please find attached OEB staff's submission with respect to the above referenced case.

Yours truly,

Original Signed by

Judith Fernandes
Project Advisor
Applications Division

Attachment

cc: All Parties to the Proceeding

ONTARIO ENERGY BOARD

OEB Staff Submission

EB-2017-0320

November 24, 2017

1 BACKGROUND

Hydro One Inc. (Hydro One) filed an application on October 11, 2016, under section 86(2)(b) of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 (Schedule B), requesting approval to purchase all of the shares of Orillia Power Distribution Corporation (Orillia Power). The OEB assigned the application (Orillia MAADs application) file number EB-2016-0276 and commenced a hearing of the matter.

On July 27, 2017, the OEB issued Procedural Order No. 6 in which it determined that the hearing of the application would be adjourned until the OEB renders its decision on a separate proceeding: Hydro One's electricity distribution rate application (EB-2017-0049).

Hydro One and Orillia Power each filed a Notice of Motion for a review and variance of the OEB's Procedural Order No. 6 on August 14, 2017 and August 16, 2017, respectively.

The OEB issued a Notice of Hearing and Procedural Order No. 1 on October 24, 2017 stating that it will hear these motions together and provided for the filing of submissions by OEB staff and intervenors. The OEB assigned file number EB-2017-0320 to this matter.

These are the submissions of OEB staff.

2 REGULATORY FRAMEWORK

2.1 The No Harm Test

In the assessment of applications relating to consolidation transactions, the OEB has applied the no harm test. The no harm test was first established by the OEB in 2005 in the Combined Decision[1], and has been considered in detail in several OEB decisions. The *Handbook to Electricity Distributor and Transmitter Consolidation* (Handbook) issued by the OEB on January 19, 2016 confirmed that the OEB will continue to apply the no harm test.

The Handbook states that the OEB considers whether the no harm test is satisfied based on an assessment of the cumulative effect of the transaction on the attainment of its statutory objectives. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

The statutory objectives to be considered are those set out in section 1 of the Act:

1 To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.

1.1 To promote the education of consumers.

2 To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

3 To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario.

4 To facilitate the implementation of a smart grid in Ontario.

5 To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities.

The OEB recognizes in the Handbook that while it has broad statutory objectives, in

[1] RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257

applying the no harm test, the OEB has primarily focused its review on impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and the financial viability of the consolidating utilities.

The Handbook states the following:

> To demonstrate "no harm", applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been. While the rate implications to all customers will be considered, for an acquisition, the primary consideration will be the expected impact on customers of the acquired utility.[2]

2.2 OEB Policy on Rate-Making Associated with Consolidation

To encourage consolidations, the OEB introduced policies that provide consolidating distributors with an opportunity to offset transaction costs with any achieved savings. The OEB 2015 Report[3] permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

Hydro One has elected to defer the rebasing of rates for Orillia Power's customers for ten years from the date of closing of the proposed share purchase transaction.

Hydro One intends to freeze base electricity distribution delivery rates for a period of five years from closing of the transaction and has requested approval for the application of a rate rider which provides a 1% reduction on base distribution delivery rates across residential and general service rate classes for that period.

From year 6 and up to year 10, rates for Orillia Power customers will be set using the Price Cap adjustment mechanism, as outlined in the OEB's 2015 Report. Hydro One has proposed to apply the OEB's Price Cap Index formula utilizing Orillia Power's efficiency cohort factor (0.3%) and this will be anchored to the Orillia Power base distribution delivery rates as approved by the OEB in EB-2015-0024.

The OEB requires consolidating entities that propose to defer rebasing beyond five years to implement an earnings sharing mechanism (ESM) for the period beyond five years to protect customers and ensure that they share in any increased benefits from consolidation during the deferred rebasing period.

[2] Page 7 - Handbook to Electricity Distributor and Transmitter Consolidations
[3] Report of the Board on Rate-making Associated with Distributor Consolidation, March 2015

Hydro One has proposed an ESM which guarantees a sharing of $3.4 million of overearnings with Orillia Power customers.

The Handbook sets out that rate-setting following a consolidation will not be addressed in an application for approval of a consolidation transaction unless there is a rate proposal that is an integral aspect of the consolidation, e.g. a temporary rate reduction. Rate-setting for a consolidated entity will be addressed in a separate rate application, in accordance with the rate setting policies established by the OEB.

The Handbook, however, also states the following:

> Consistent with recent decisions, the OEB will not consider temporary rate decreases proposed by applicants and other such temporary provisions to be demonstrative of "no harm" as they are not supported by, or reflective of the underlying cost structures of the entities involved and may not be sustainable or beneficial in the long term. In reviewing a transaction, the OEB must consider the long term effect of the consolidation on customers and the financial sustainability of the sector.[4]

[4] Page 7 - Handbook to Electricity Distributor and Transmitter Consolidations

3 SUBMISSIONS

3.1 Threshold

The OEB has asked for submissions on both the merits of the motions and on the "threshold" question. Rule 43.01 of the OEB's Rules of Practice and Procedure states: "In respect of a motion brought under Rule 40.01, the Board may determine, with or without a hearing, a threshold question of whether the matter should be reviewed before conducting any review on the merits."

Rule 42.01(a) provides the grounds upon which a motion may be raised with the OEB: Every notice of a motion made under Rule 40.01, in addition to the requirements under Rule 8.02, shall:

(a) set out the grounds for the motion that raise a question as to the correctness of the order or decision, which grounds may include:

(i) error in fact; (ii) change in circumstances; (iii) new facts that have arisen; (iv)facts that were not previously placed in evidence in the proceeding and could not have been discovered by reasonable diligence at the time.

Note that this list is not exhaustive, and the OEB can allow a motion to review for other grounds as well.

The OEB`s most thorough analysis of Rule 43.01 came from a decision on several motions filed in the Natural Gas Electricity Interface Review Decision (NGEIR Review Decision):

> Therefore, the grounds must "raise a question as to the correctness of the order or decision". In the panel's view, the purpose of the threshold test is to determine whether the grounds raise such a question. This panel must also decide whether there is enough substance to the issues raised such that a review based on those issues could result in the Board deciding that the decision should be varied, cancelled or suspended.
>
> With respect to the question of the correctness of the decision, the Board agrees with the parties who argued that there must be an identifiable error in the decision and that a review is not an opportunity for a party to reargue the case.
>
> In demonstrating that there is an error, the applicant must be able to show that the findings are contrary to the evidence that was before the panel, that the panel failed to address a material issue, that the panel made inconsistent findings, or something of a similar nature. It is not enough to argue that conflicting evidence should have

> been interpreted differently. The applicant must also be able to demonstrate that the alleged error is material and relevant to the outcome of the decision, and that if the error is corrected, the reviewing panel would change the outcome of the decision.
>
> In the Board's view, a motion to review cannot succeed in varying the outcome of the decision if the moving party cannot satisfy these tests, and in that case, there would be no useful purpose in proceeding with the motion to review.[5]

In relation to applications by Hydro One Networks Inc. and Great Lakes Power Limited for the review and approval of their respective connection procedures, the OEB further commented: "in the case of an applicant-driven motion to review, it is not sufficient to simply reargue the case, or to argue that a different outcome might have been preferred. The moving party must show that the decision at issue is incorrect in an identifiable, relevant and material way."[6]

The purpose of a motion to review, therefore, is not simply to re-hear the original issue before the OEB. Most issues before the OEB require a significant exercise of judgment on behalf of the OEB panel, and lend themselves to a number of possible outcomes. The purpose of a motion to review is not for a party to simply re-argue the same case in front of a different panel in the hope of achieving a different outcome. Similarly, the task of a reviewing panel is not to consider the matter afresh – a motion to review is not a hearing de novo. The role of the reviewing panel is not to consider the evidence and decide what outcome it would have arrived at. A reviewing panel should instead look at the matter and determine if the original panel made an identifiable and material error of law or fact. If the answer to that question is "no", then the motion must fail.

The moving parties do not spend much time in their submissions addressing the test set out in Rule 43.01. The grounds do not fit neatly into any of the categories described in Rule 42.01. In essence, however, their argument (at least as it would apply to the threshold test) is that this motion would in fact be their first opportunity to address the relevance of the distribution application and the appropriateness of a lengthy adjournment.

The moving parties have argued that they were never afforded the opportunity to make submissions on the adjournment issue at all, which is the basis of their procedural fairness argument. In their view they were not provided with "the right to be heard" on an issue that has a material impact on their regulated businesses. If this were correct, it is OEB staff's view that this would be an appropriate topic for a motion to review – in

[5] Motions to Review the *Natural Gas Electricity Interface Review* Decision, EB-2006-0322/0338/0340, May 22, 2007, page 18
[6] Decision and Order, Hydro One and Great Lakes Power, EB-2007-0797, page 8

other words the threshold would be passed. Parties should have the opportunity to make submissions on all issues that could impact them materially.

The adjournment ordered in Procedural Order No. 6 was an order related strictly to process. The OEB routinely issues procedural decisions without giving parties an opportunity to make submissions. In most cases this is an appropriate practice – generally speaking parties' rights are not materially impacted by pure process issues such as filing dates or other deadlines. However, there are cases where a pure process question could have a significant impact on a party. It is possible, for example, that a lengthy delay in a proceeding could cause harm to a party.

In OEB staff's view, it is not entirely correct to say that the moving parties had no opportunity to address the relevance of the distribution case on the MAADs proceeding. SEC raised the issue squarely in its final submissions, and Hydro One responded in its reply argument. The motions are not the first time that this issue has been discussed, though on account of timing issues (the distribution rate application was not filed until the MAADs case was well under way) it was not explored thoroughly through the interrogatory process.

However, the OEB may not have had a full appreciation of the potential impacts that a lengthy delay would have on the application. In particular the information provided by Orillia Power with its motion materials is not something that was available to the OEB when it made the decision to adjourn the proceeding.

OEB staff is therefore satisfied that the threshold issue has been passed, and that the OEB should consider this motion on its merits. The information presented with the motions was not all available to the OEB when Procedural Order No. 6 was issued, and it is at least potentially relevant to that decision. Hydro One provided a ten year customer rate forecast, comparing Orillia Power customers' rates status quo to the rate benefit they will receive if the Orillia MAADs application is approved, using rate-making assumptions provided in the application. Hydro One submitted that Orillia Power customers receive a cumulative bill benefit or savings between approximately $600 and $1800. Orillia Power provided affidavit evidence relating to operational problems for Orillia Power caused by the delay in the decision on the MAADs application.

3.2 Merits

In the Orillia MAADs application, Hydro One submitted that cost savings will result from the acquisition of Orillia Power, which total more than $4M annually. The overall expected savings are based on comparing Orillia Power, remaining as a stand-alone

distribution utility, to having Orillia Power's operations becoming integrated with Hydro One's existing operations.

Hydro One has also submitted that its OM&A cost per customer (for its high density rate class (UR)) is lower as compared to Orillia Power's cost per customer. For these reasons, Hydro One argued that the proposed transaction will result in downward pressure on cost structures relative to the status quo, and that therefore the no harm test has been met.

Over the past few years, Hydro One has acquired three electricity distributors (Norfolk Power Distribution Inc., Haldimand County Hydro Inc., and Woodstock Hydro Services Inc.) through consolidation applications approved by the OEB. Under the terms of those acquisitions, the three distributors had a deferred rebasing period of five years, during which base distribution rates were reduced by 1% and were frozen. In those cases, Hydro One similarly argued that the cost structures of those utilities would be lower than they would have been if the utilities remained as stand-alone entities.

Around the time final submissions were filed (and after the discovery process was finished) in the Orillia MAADs application, Hydro One filed a five year distribution rate application with the OEB[7]. The three previously acquired distributors' deferred rebasing periods all end during the test period, and therefore Hydro One has proposed new rates for them. The residential and general service customers of the acquired distributors are not being merged into Hydro One's existing rate classes. Rather, Hydro One has created a new set of rate classes for these customers, known as the acquired rate classes. As such, costs are being allocated directly to these new classes.

Hydro One's distribution rate proposal for customers of these previously acquired distributors proposes large distribution rate increases for certain customer classes once the deferred rebasing period elapses. Intervenors in the Orillia MAADs application have argued that this demonstrates that the overall savings that Hydro One promised through the MAADs applications for those utilities have not come to pass. They argue that the same thing is very likely to happen to Orillia once the deferral period is over; in other words that there will not be enduring cost savings for Orillia Power customers and consequently, these customers will face cost increases in excess of what they would have faced absent an acquisition.

In Procedural Order No. 6, the OEB determined that the Orillia MAADs application would be held in abeyance until Hydro One's five year distribution rate application is completed.

[7] EB-2017-0049

It stated: “It is not apparent to the OEB that Hydro One’s cost allocation proposal [in the distribution rate case] responds positively to the expectation that the future rates for the customers of those acquired service areas would be reflective of the lower costs. The OEB has determined that Hydro One should defend its cost allocation proposal in its distribution rate application prior to the OEB determining if the Orillia acquisition is likely to cause harm to any of its current customers.”

Hydro One and Orillia Power have filed motions on the following grounds:

1) None of the information in the distribution rate application relates to Orillia Power, and it is therefore irrelevant to the consolidation application.
2) Hydro One and Orillia Power were not afforded procedural fairness because they did not have an opportunity to make submissions on the adjournment.
3) The consolidation application meets the no harm test and policy direction issued by the OEB and that waiting for a year or more for the distribution rate decision is an unreasonable delay.
4) The adjournment should be overturned and the panel should make its final decision on the Orillia MAADs application based on the evidence it already has in front of it.
5) The delay caused by an adjournment will impose operational challenges for Orillia Power, as some staff have left and it is not clear if they can be replaced given the uncertainty over Orillia Power’s future.

OEB staff submits that the motion should be granted in part.

OEB staff agrees that any information from the distribution rate application is not directly relevant to the consolidation application.

As stated previously, Hydro One has created a new set of rate classes for the customers of the three previously acquired distributors, known as the acquired rate classes. Orillia Power is not part of the application, and there is no direct information in the application regarding what Orillia Power’s rates or overall cost structures would be. However, the distribution rates case could well be indicative of Hydro One’s overall strategy with respect to acquired utilities, and what may happen to both overall cost structures and rates following a deferral period. It serves as a test case regarding whether any overall promised savings actually result in overall lower cost structures.

Hydro One has not indicated (either in the distribution rates case, or the Orillia MAADs application) what its rate proposal for Orillia Power customers will be following the deferral period. Indeed the distribution rates case has no information about Orillia Power at all. (The fact that actual rates are not addressed in the MAADs application is consistent with

the Handbook, although the OEB has also been clear that overall cost structures following the deferral period are relevant.) For this reason, OEB staff submits that it will not necessarily be helpful to the OEB to have the complete record and decision from the distribution rates case available before making a decision on the Orillia MAADs application. Hydro One may well have different plans for Orillia Power, and the relevance of the information from the distribution rates case will be largely speculative. The OEB may find itself no better off having waited for that decision. Given the significant delay that waiting for the distribution case would entail, and the potential operational issues being faced by Orillia Power in the interim, OEB staff suggests that the adjournment is not the optimal course.

That said, OEB staff also believes that the information received to date in the distribution case certainly raises concerns. Although the evidence in that proceeding still needs to be tested and further analyzed, it certainly seems as though overall cost structures for the acquired utilities may not in fact be lower (or at least no worse) than they would have been had Orillia Power not been acquired, at least for some rate classes.

In addition, the efficacy of the rate plan (which is part and parcel of the MAADs transaction) beyond the deferral period is in question given the information in the distribution rate case regarding the previously acquired utilities. These should be areas of concern for the OEB, and should be explored fully before an approval for the Orillia MAADs application is issued. Ideally this would have happened through the discovery process. However, the distribution case was filed after the discovery phase of the MAADs application was completed, and this is what alerted parties to the fact that there could be significant rate increases (which result from higher overall cost structures) after a deferral period ends.

In OEB staff's view, it is a critical element of the OEB's review of MAADs applications to test the efficacy of any rate plan, including testing for a "catch-up" scenario, once the deferral period has expired. Double digit distribution rate increases may be an indicator of rates being "caught up" to what they otherwise would have been without the rate freeze.

In both its Orillia MAADs application and its argument on the motion, Hydro One points to cost savings in excess of $4M annually resulting from the acquisition. Although this may be true, cost savings aren't necessarily the same as lower overall cost structures for the acquired customers. The distribution rate application suggests that overall cost structures may in fact rise even in the face of some savings. The savings therefore are only a part of the picture with respect to the overall cost structures.

OEB staff recognizes that the OEB has been clear that a MAADs case is not the place to

discuss actual rates – that is the purview of a rates case. However, the Handbook does say that "Rate-setting following a consolidation will not be addressed in an application for approval of a consolidation transaction unless there is a rate proposal that is an integral aspect of the consolidation e.g. a temporary rate reduction."[8]

Therefore, it is appropriate to discuss overall cost structures following a deferral period; indeed that is how the no harm test is meant to be assessed. As described in the Handbook, "In reviewing a transaction, the OEB must consider the long term effect of the consolidation on customers and the financial sustainability of the sector." OEB Staff believes that this includes considering whether the underlying cost structures are sustainable and beneficial beyond the proposed 10 year deferral period. OEB staff notes that the 10 year deferral period is an option selected by the proponent and is not a minimum requirement of the OEB's MAADs policy.

In OEB staff's view, it is unlikely that the decision on Hydro One's five year distribution rate application will provide the information that is required, largely because that case does not include Orillia Power and the extent to which it is indicative of what will happen to Orillia Power may be indicative but is also speculative. OEB staff also notes that a lengthy delay to the MAADs proceeding may impose operational challenges for Orillia Power.

OEB staff submits that the matter be referred back to the panel on the Orillia MAADs application and suggests that, if the panel believes more or better information is required, the panel should re-open the record in the Orillia MAADs application and require the production of that information. This could include requiring Hydro One to file more information regarding what the overall cost structures (as opposed to a simple calculation of some of the savings that might result from the acquisition) are expected to be following the deferral period. It might also want more information on the rate structure that it will employ for Orillia Power after the deferred rebasing period, including a forecast of Orillia Power's allocated costs and how that compares with the status quo. The focus need not be on Orillia Power's specific rates, but on whether the overall costs allocated to Orillia Power can reasonably be shown to be lower (or at least not higher) than the status quo.

All of which is respectfully submitted.

[8] Page 11- Handbook to Electricity Distributor and Transmitter Consolidations